### NOTES TO COMBINED FINANCIAL STATEMENTS

# 1. Summary of Significant Accounting Policies

#### **Presentation Basis**

The financial statements of the Wisconsin Department of Employe Trust Funds (Department) have been prepared in conformity with generally accepted accounting principles (GAAP) for government units as prescribed by the Governmental Accounting Standards Board. The Department is part of the State of Wisconsin financial reporting entity.

The following funds and account groups have been used to account for the assets and operations of the Department.

#### Governmental Funds:

General Fund

Special Revenue Fund-Administration Fiduciary Funds:

Pension Trust Fund

**Expendable Trust Funds:** 

- Accumulated Sick Leave (Post Retirement Health Insurance)
- Group Life Insurance
- Employe Reimbursement Accounts
- Milwaukee Special Death Benefit
- Deferred Compensation

**Investment Trust Fund:** 

- Milwaukee Retirement Systems

# **Proprietary Funds:**

Enterprise Funds:

- Group Health Insurance
- Group Income Continuation Insurance
- Duty Disability
- Long-Term Disability Insurance

#### Account Group:

General Fixed Assets Account Group

Amounts in the "Memorandum Only Totals" columns in the combined financial statements are a summation of line items and are presented for comparative purposes only. The amounts in these columns are not comparable to a consolidated presentation and do not present the consolidated financial position, results of operations, or changes in financial position.

# **Basis of Accounting**

The financial statements of the Department have been prepared in accordance with generally accepted accounting principles. All Governmental and Expendable Trust Funds are accounted for using the flow of current financial resources measurement focus and the modified accrual basis of accounting. The modified accrual basis of accounting recognizes revenues when they become measurable and available, and expenditures when the related fund liability is incurred. Pension, Investment Trust Funds and Enterprise Funds are accounted for using the flow of economic resources measurement focus and a full accrual basis of accounting. Under the accrual basis of accounting. revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. FASB statements effective after November 30, 1989 are not applied in accounting and reporting for proprietary operations.

#### **Investment Valuation**

Benefit plan assets (except Deferred Compensation) are invested in one of three investment pools managed by the State of Wisconsin Investment Board (SWIB):

- 1) the Fixed Retirement Investment Trust (FRIT), a broadly diversified mix of investments that includes equities, fixed income, private placements and limited partnerships, real estate and cash;
- 2) the Variable Retirement Investment Trust (VRIT), which is invested primarily in equities; and
- 3) the State Investment Fund (SIF), a liquid fund invested primarily in obligations of the U.S. Government and its agencies and high-quality commercial bank and corporate debt obligations. These investment pools are managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. It is not registered with the Securities and Exchange Commission as an investment company.

The investments of the FRIT and VRIT are valued at fair value, per s. 25.17(14), Wis. Stats., except for State Investment Fund shares, which are valued at amortized cost which approximates fair value.

Generally fair value is determined monthly and is based on quoted market prices but a number of other pricing methods are used for various types of investments.

Private placements and mortgages are priced via a matrix pricing system based on public fixed income trades quoted by investment securities firms. The traditional discounted cash flow methodology is employed, where discounted rates, based on current yields in the base Treasury, consider factors such as coupon rates, term to maturity, Moody's and S&P ratings, and sector/industry information.

Limited partnerships' fair value is estimated based on periodic reports from the limited partnerships' management. Annually, these reports are audited by independent auditors.

Index options are priced on the Black-Scholes model which is based on strike prices,

implied volatility, time to maturity, style, type of option and interest rates. Currency options are priced by an independent pricing source specializing in the valuation of options based on the Garman Khol-Hargen model. Relative performance options are priced by the brokers from whom the option was purchased.

The basis for valuing real estate is appraisals which are prepared once every three years. In years when appraisals are not performed the asset managers are responsible for providing market valuations.

A limited number of securities are carried at cost. Certain non-public or closely held stock are not reported at fair value, but are carried at cost since no independent quotation is available to price these securities.

The retirement fund investments consist of shares in the FRIT and VRIT, which also own shares in the SIF. Shares of the SIF owned by the pension funds, certificates of deposit, and international cash balances are classified as "Cash and Cash Equivalents" on the balance sheet.

Wisconsin statutes require that a Transaction Amortization Account (TAA) be maintained to smooth the impact of fair price volatility on the benefit plans invested in the FRIT. All realized and unrealized gains and losses in fair value of investments in the FRIT are recorded in the TAA as they are incurred. To recognize the legal restrictions on the use of the TAA for current operations, the fund balances of the participating programs are reserved for the amount in the TAA and shown as a Reserve for Market Value Adjustments. Twenty percent of the TAA balance as of December 31 of each year is transferred from the Reserve for Market Value Adjustments to program reserves.

Year-end balances in the Transaction Amortization Account (in millions \$) for the last five years after annual distributions were as follows:

December 31, 1995	\$ 5,892
December 31, 1996	7,405
December 31, 1997	9,801
December 31, 1998	11,495
December 31, 1999	13,910

The assets of the Income Continuation Insurance, Duty Disability, Long-Term Disability Insurance, Milwaukee Special Death Benefit, Milwaukee Retirement Systems, and Accumulated Sick Leave programs are invested in the FRIT. Earnings are allocated between the Retirement System and other programs based on the average balance invested for each program. Earnings allocated to other programs are classified as "Investment Income Distributed" on the Statement of Changes in Net Assets. These programs' investment in the FRIT is classified as "Investment in Fixed Fund" on the balance sheet. All other benefit plan assets are invested in the SIF. Investments in the SIF are classified as "Cash and Cash Equivalents" on the balance sheet.

For the Deferred Compensation plan, investments in fixed earnings accounts are valued at current book values, which approximates fair value, while variable earnings investments are presented at fair values based on published quotations at December 31. Annuity payout reserves are actuarially valued.

# **Administrative Expenses**

The Department incurs two types of administrative expenses: administrative costs incurred by the Department to administer its programs, and administrative costs incurred by SWIB and reimbursed by the Department for investing the trust funds.

The administrative costs of all Department programs are financed by a separate appropriation and are allocated to the benefit plans in accordance with Wis. Stats. § 40.04. The sources of funds for this appropriation are investment earnings and third-party reimbursement received from the various programs administered by the Department. Estimated administrative expenses are allocated to programs at the beginning of each fiscal year and adjusted to actual after the end of the year. The expense recognized for calendar year 1999 includes actual adjusted expenses for January 1, 1999, through June 30, 1999, and estimated expenses for July 1, 1999, through December 31, 1999.

The Department's administrative budget is established by the state legislature for fiscal years ending June 30. Following is a comparison of the authorized budget to actual expenditures and outstanding encumbrances for the fiscal year ended June 30, 1999.

	Authorized Budget	Expenditures	Encumbrances	Unexpended Balanced
Automated Operating Systems	\$ 2,481,886	\$ 1,823,714	\$ 140,188	\$ 517,984
Benefit Administration	10,000	0	0	10,000
Health Care Data Collection	282,544	262,963	0	19,581
General Administration	12,601,341	12,068,518	113,611	419,212
IT Administration	<u>1,710,352</u>	1,643,767	66,459	<u>126</u>
Totals	<u>\$ 17,086,123</u>	<u>\$ 15,798,962</u>	<u>\$ 320,258</u>	<u>\$ 966,903</u>

SWIB administrative expense is comprised of salaries, supplies, services, and equipment necessary for the investing activities of state funds. The administrative expenses are billed to the agencies for which investments are made. In 1999, SWIB administrative expense for the FRIT and VRIT was \$10,112,287 and \$1,208,022 respectively.

In compliance with Wis. Stats. § 25.187(2), these costs were charged directly to the current income of each fund.

As of December 31, 1999 and 1998 respectively, \$1,340,234 and \$1,825,911 were reserved for encumbrances.

#### **Fixed Assets**

All fixed assets are purchased through the Special Revenue Administrative fund, and are reported at original cost in the General Fixed Asset Account Group. During 1999 the fixed asset balance changed as follows:

1/1/99 Equipment Balance	\$ 3,918,574
Equipment Acquired	61,143
Equipment Disposed Of	(155,155)
12/31/99 Equipment Balance	\$ 3,824,562

#### **Interfund Assets / Liabilities**

Interfund assets and liabilities at December 31, 1999 consist of the following (in thousands):

Fund	Due From Other Trust Funds	Due to Other Trust Funds
Special Revenue (Administration)	\$ 2,777.8	\$ 1,869.5
Wisconsin Retirement System	1,015.9	1,129.1
Milwaukee Death Benefit	20.8	1.2
<b>Duty Disability</b>	0.0	394.9
Long Term Disability Insurance	0.0	234.1

Fund	Due From Other Trust Funds	Due to Other Trust Funds
Deferred Compensation	0.0	63.0
Employe Reimbursement Accounts	84.8	0.0
Sick Leave Conversion	140.3	144.5
Life Insurance	434.4	0.0
City of Milwaukee Retirement Systems	0.0	0.3
Income Continuation Insurance	0.0	321.4
Health Insurance	232.5	548.6
Totals	<u>\$ 4,706.6</u>	\$ 4,706.6

Due From/To Other Trust Funds represents short-term interfund accounts receivable and payable between funds administered by the Department.

# 2. Accounting Changes

#### A. Reclassifications

Certain amounts in the 1998 financial statements have been reclassified to conform to 1999 financial statement presentation.

# 3. Deposits and Investments

#### **Deposits**

GASB Statement 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed. Deposits as of December 31, 1999 included \$1,358,460 deposited in two financial institutions. Federal depository insurance covers \$1,451 of the deposits, while the remainder is uninsured. In addition, SWIB held a number of nonnegotiable short-term certificates of deposit. The fair value of these certificates of deposit was approximately \$35 million, all of which was uncollateralized.

#### **Investments**

GASB Statement 3 also requires investments to be categorized to indicate the level of risk assumed by the State of Wisconsin Investment Board (SWIB) at year end. The categories are:

- 1. Insured or registered, or securities which are held by SWIB in SWIB's name or its agent in SWIB's name;
- 2. Uninsured and unregistered, with the securities held by the counterparty's trust department or agent in SWIB's name;
- 3. Uninsured and unregistered, with the securities held by the counterparty, or by its trust department or agent, but not in SWIB's name.

The following table, based on SWIB's accounting records, provides the risk categorization for investments held by SWIB as of December 31, 1999. Fair value information represents actual bid prices or the quoted yield equivalent at the end of the calendar year for securities of comparable maturity, quality and type as obtained from one or more major investment brokers.

	Category (in millions)			
	"1"	<b>"2"</b>	"3"	Fair Value
Bonds	\$ 9,710.7	\$ 0	\$ 0	\$ 9,710.7
Stocks	23,163.7	7.3	0	23,171.0
Repurchase Agreements	14.1	0	0	14.1
Bankers Acceptances	<u>543.0</u>	<u>0</u>	<u>0</u>	<u>543.0</u>
Totals	<u>\$ 33,431.5</u>	<u>\$ 7.3</u>	<u>\$ 0</u>	<u>\$ 33,438.8</u>
	Investments Not Subje	ct to Categorizatio	<u>n</u> :	
Pooled Equities				18,701.5
Private Placements				3,126.4
Pooled Bonds				4,059.9
Limited Partnerships				2,520.1
Investment in State's Investme	nt Fund			618.1
Pooled Cash and Cash Equiva	ents			271.9
Mortgages				386.5
Real Estate				448.3
Financial Futures Contracts				0.4
Options				48.4
Investments Held By Broker D	ealers Under Securities	s Loans:		
Bonds				2,094.5
Equities				662.6
Securities Lending Cash Colla	teral Pooled Investmen	ts		425.0
Totals				\$ 66,802.4

If quoted market prices are not available, a variety of third party pricing methods are used, including appraisal, certifications, pricing models and other methods deemed acceptable by industry standards.

All investments of the Deferred Compensation program are in externally managed investment pools and have not been included in the schedule. As of December 31, 1999, the investments included (in millions):

Variable Earnings (Mutual Fund) Investments	\$ 1,006.8
Insured Fixed Earnings Investments	30.7
Fixed Earnings Investment	152.8
Allocated Insurance Contracts	8.2
Total	\$ 1.198.5

#### **Securities Lending Transactions**

State statutes and board policies permit SWIB to use investments to enter into securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities for collateral, in the form of cash or other securities, with the simultaneous agreement to return the collateral for the same securities in the future. SWIB's securities custodian is an agent in lending the plans' domestic and international securities for collateral of 102 percent and 105 percent, respectively, of the loaned securities' fair value. The cash collateral is reinvested by the lending agent in accordance with contractual investment guidelines which are designed to insure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

Securities on loan at December 31, 1999 are presented as unclassified in the preceding

schedule of custodial risk. At year end, SWIB had no credit risk exposure to borrowers because the amounts SWIB owed the borrowers exceeded the amounts the borrowers owed SWIB. The contract with the lending agent requires them to indemnify SWIB if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

The majority of securities loans can be terminated on demand by SWIB or the borrower, although the average term of the loans is approximately one week. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short term investments with a weighted average maturity of 23 days.

The ability to pledge or sell collateral securities cannot be made without a borrow default. In addition, no restrictions on the amount of loans exist or can be made.

#### **Derivative Financial Instruments**

A. Foreign Currency Forwards and Options

SWIB's derivative activities primarily involve forward contracts and foreign currency options. Generally, foreign currency forwards and options are held to hedge foreign exchange risk. Market risk is controlled by holding substantially offsetting purchase and sell positions. At December 31, 1999 the fair value of foreign currency forward contract assets totaled \$1.70 billion, while the liabilities totaled \$1.72 billion.

Forward commitments represent obligations to purchase or sell foreign currencies, with the seller agreeing to make delivery at a specified future date and a specified price. Options on foreign currencies provide the holder the right, but not the obligation, to purchase or sell foreign currencies on a certain date at a specified price. The seller (writer) of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk to the extent of the premium paid.

As of December 31, 1999, SWIB held one foreign currency call option to enhance earnings in the event of certain foreign

currency fluctuations. There is no market risk associated with owning this instrument beyond the initial cost of its purchase.

### B. Other Options

SWIB held equity option contracts for trading purposes during the periods presented in the financial statements. These option contracts give the purchaser of the contract the right to buy (call) or sell (put) the equity security or index underlying the contract at an agreed upon price (strike price) during or at the conclusion of a specified period of time. The seller (writer) of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk to the extent of the premium paid.

All of the written calls are covered calls and as such any volatility in the price of the option is offset by the corresponding inverse relationship in the value of the underlying security.

#### C. Futures Contracts

One of the outside investment managers uses futures contracts to manage its exposure to the stock market. Upon entering into a futures contract, the outside manager is required to deposit with the broker, in SWIB's name, an amount of U.S. government obligations in accordance with the initial margin requirements of the broker. Futures contracts are marked to market daily with gains and losses being recognized. The variation margin is settled daily until the contracts expire or are closed. Futures contracts involve, to varying degrees, risk of loss in excess of the variation. Losses may arise from the changes in the value of the underlying instrument, illiquidity in the secondary market for the contracts, or if the counterparties do not perform under the terms of the contract. Futures contracts are valued each day at the settlement price established by the board of trade or exchange on which they are traded.

# D. Collateralized Mortgage Obligations

Collateralized mortgage obligations (CMOs) are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes or traunches in accordance with each CMOs established payment order. Some CMO traunches have more stable cash flows relative to changes in interest rates while others are significantly more sensitive to interest rate fluctuations. In a declining interest rate environment, some CMOs may be subject to a reduction in interest payments as a result of prepayments of mortgages which make up the collateral pool. A reduction in interest payments causes a decline in cash flows and thus a decline in the fair value of the security. Rising interest rates may cause an increase in interest payments, thus an incerease in fair value of the security. CMOs are held to maximize yields and in part to hedge against a rise in interest rates.

#### D. Principal Only Strips

Prinicpal Only Strips are securities that derive cash flow from the payment of principal on underlying debt securities. SWIB holds several principal only strips for yield enhancing purposes. The underlying securities are United States Treasury obligations, therefore the credit risk is low. On the other hand, principal only strips are more volitile in terms of pricing, and thus the market risk is higher than tradional United States Treasury obligations.

# **Unfunded Capital Commitments**

Partnership agreements generally set a limit on the total dollar amount that limited partners must commit to funding when entering the partnership. Over the life of the partnership, the general partner will request capital contributions totaling the agreed upon limit. As of December 31, 1999, unfunded capital commitments totaled \$1.2 billion.

# 4. Description of Pension Trust Fund

The Wisconsin Retirement System (WRS) is a cost-sharing multiple employer public employer retirement system established and administered by the State of Wisconsin to provide pension benefits for state and local government public employes. The system is administered in accordance with Chapter 40 of the Wisconsin Statutes.

### WRS Employers

WRS is open to all public employers in Wisconsin. Participation is optional, except that participation is mandatory for school districts with respect to teachers, some municipalities with respect to police and firefighters, and all counties except Milwaukee County. As of December 31, 1999, the number of participating employers was:

State Agencies	60
Cities	153
Counties	71
4th Class Cities	34
Villages	189
Towns	155
School Districts	426
CESA's	12
WTCS Districts	16
Special Districts	154
<b>Total Employers</b>	<u>1,270</u>

#### **WRS Membership**

Any employe of a participating employer who is expected to work at least 600 hours per year must be covered by WRS.

#### As of December 31, 1999, the WRS

Current Employes:	
General / Teachers	232,529
Elected / Executive / Judges	1,488
Protective with Social Security	16,579
Protective without Social	<u>2,702</u>
Security	
<b>Total Current Employes</b>	253,298
Terminated Participants	107,032
Retirees and Beneficiaries	
Currently receiving benefits:	
Retirement Annuities	95,747
Disability Annuities	5,811
Death Beneficiary Annuities	1,259
Total Annuitants	102,817
Total Participants	<u>463,147</u>
membership consisted of:	

#### **WRS Benefits**

WRS provides retirement benefits as well as death and disability benefits. Participants in the system prior to January 1, 1990, were fully vested at the time they met participation requirements. For participants entering the system between December 31, 1989 and April 23, 1998, creditable service in each of five years was required for vesting. 1997 Wis. Act 69 provided for all active participants in the system on or after April 24, 1998 to be fully vested.

Employes who retire at or after age 65, (55 for protective occupations and 62 for elected officials and executive service retirement plan participants), are entitled to an annual formula retirement benefit in an amount equal to 1.6 percent, (2 percent for elected officials, and protective occupations covered by Social Security, and 2.5 percent for protective occupations not covered by Social Security), of their final average earnings and creditable service. Final average earnings is the average of the participant's three highest annual earnings periods. Creditable service includes current service and prior service for which a participant received earnings and made contributions as required. Creditable service also includes creditable military service. The retirement benefit will instead be calculated as a money purchase benefit based on the employe's contributions plus matching employer's contributions with interest if that benefit is higher than the formula benefit.

Vested participants may retire at or after age 55, (50 for protective occupations), and receive an actuarially reduced benefit. Participants terminating covered employment prior to eligibility for an annuity may either receive employe-required contributions plus interest as a separation benefit, or leave contributions on deposit and defer application until eligible to receive a retirement benefit.

#### **Post-Retirement Adjustments**

The Employe Trust Funds Board may periodically increase annuity payments from the retirement system when investment income credited to the reserves, together with other actuarial experience factors, creates surplus reserves as determined by the actuary. Annuity increases are not based on cost of living or other similar factors.

The fixed dividends and variable adjustments granted during recent years are as follows:

Year	Fixed Dividend		Variable Adjustment	
1990	11.3	%	16.0	%
1991	3.6		(14.0)	
1992	6.3		18.0	
1993	4.4		5.0	
1994	4.9		11.0	
1995	2.8		(4.0)	
1996	5.6		19.0	
1997	6.6		14.0	
1998	7.7		18.0	
1999	7.2		12.0	

#### **Actuarial Liabilities**

WRS's unfunded actuarial accrued liability (UAAL) is being amortized as a level percentage of payroll over a 40-year period beginning January 1, 1990. As of December 31, 1999, 30 years remain on the amortization schedule. Interest is assessed on the outstanding liability at year-end at the assumed earnings rate. The level-percentageof-payroll amortization method results in a relatively lower dollar contribution in earlier years than in later years when payrolls have increased. During the early years of the amortization period, payments made are less than annual interest assessments, resulting in an increase in the liability. As payrolls increase annually, prior service payments increase proportionally until they exceed annual interest, and finally fully liquidate the liability at the end of 40 years. State law requires the accrued retirement cost be funded

The Employe Trust Funds Board (ETFB) periodically reviews, and if appropriate, adjusts the assumptions used in calculating the actuarial liability. Their past practice has been to restate the UAAL for those employers who have an UAAL at the time of the assumption change. Employer UAAL balances have been reduced by approximately \$235 million as a result of this procedure. A legal opinion from the Attorney General's Office has concluded that the ETFB does not have the authority to adjust employer UAAL balances. The ETFB has requested legislative action to affirm their authority to adjust UAAL balances as appropriate.

As of December 31, 1999 and 1998, the unfunded actuarial accrued liability was \$2.11 billion and \$2.19 billion respectively. These amounts are presented as Prior Service Contributions Receivable on the Statement of Plan Net Assets.

#### **Variable Retirement Option**

Prior to 1980, WRS participants had an option to have one-half of their required contributions and matching employer contributions invested in the Variable Retirement Investment Trust (VRIT). Retirement benefits were adjusted for the difference between the investment experience of the Fixed Retirement Investment Trust (FRIT) and VRIT. The VRIT was closed to new membership after April 30, 1980. Provisions for allowing members to withdraw from the VRIT were added with the passage of Ch. 221, Laws of 1979. As of December 31, 1999, 18,456 active and inactive participants and 26,257 annuitants remained in the VRIT.

# **Municipal Police and Firefighters Pension Group**

As of March 31, 1978, administration of certain local funds for police officers and firefighters was assumed by the Wisconsin Retirement Fund. This included approximately 2,000 members. As of December 31, 1999, 744 participants remained in the system. These funds were previously closed to new members after January 1, 1948.

The liability for retirement benefits for these annuitants is funded by the employers as benefit payments are made. Annuity reserves for these police and firefighter annuities are established by a transfer from the employer accumulation reserve at the time the annuity is approved. Earnings on these reserves are used to fund dividends on the same basis as for WRS annuitants. The unfunded liability for these annuitants as of December 31, 1999, and December 31, 1998, was \$33.3 million and \$36.4 million respectively.

### **Annuity Supplement - General Fund**

As authorized under 1985 Wis. Stats. § 40.27 (1), the General Fund provides certain supplemental annuity benefits to annuitants receiving a continuing annuity on or before September 1974. The benefit is subject to continuation of the appropriation by the Legislature. The Department serves as a clearing agent for its payment.

# 5. Contributions Required and Made

#### **Required Contributions**

Employer contribution rates are determined by the "entry age normal with a frozen initial liability" actuarial method.

This is a "level contribution" actuarial method intended to keep employer and employe contribution rates at a level percentage of payroll over the years. This method determines the amount of contributions necessary to fund: 1) the current service cost, which represents the estimated amount necessary to pay for benefits earned by the employes during the current service year plus actuarial gains or losses arising from the difference between actual and assumed experience; and 2) the prior service cost, which represents the estimated amount necessary to pay for unfunded benefits earned prior to the employer becoming a participating employer in WRS and the past service cost of benefit improvements.

1999 contribution requirements were determined by the December 31, 1997

actuarial valuation. Significant actuarial assumptions used in the valuation include:

- a rate of return on the investment of present and future assets of 8.0 percent per year compounded annually;
- projected salary increases of 4.8 percent per year compounded annually, attributable to inflation;
- additional projected salary increases ranging from 0.0 percent to 6.0 percent per year, depending on age and type of employment, attributable to seniority/merit; and
- 2.9 percent annual post-retirement benefit increases.

Employe contributions are deducted from the employe's salary and remitted to the Department by the participating employer. Part or all of the employe contributions may be paid by the employer on behalf of the employe.

Employes also make an actuarially determined benefit adjustment contribution. The benefit adjustment contribution is treated as an employer contribution for benefit purposes and is not included in separations, death benefits, or money purchase annuities. Part or all of the benefit adjustment contribution may be paid by the employer on behalf of the employe. Effective January 1, 1990, any changes in the contribution rate must be split equally between the employe and the employer.

Contribution rates in effect during 1999 by employment category were:

Elected Officials, State Executive Retirement Plan	Employer Current 9.8%	Employer Prior* 1.0%	Employe 4.3%	Benefit Adjustment Contribution 0.0%
Protective Occupation with Social Security	8.0%	0.9%	4.9%	0.0%
Protective Occupation without Social Security	12.8%	1.5%	5.4%	0.0%
General and Teachers	4.4%	1.4%	5.0%	0.8%

<sup>\*</sup> The employer prior service contribution rate is a weighted average of individual employer rates.

Contributions required and made during 1999 were:

	Contributions (millions \$)	Percentage of Payroll
Employer Current Service	\$ 433.2	4.9%
Employer Prior Service	223.3	2.5
Employe Required	441.6	5.0
Benefit Adjustment Contribution	63.8	0.7

Employer prior service contributions are recorded as a reduction in the Prior Service Contribution Receivable.

# **Employe and Employer Additional Contributions**

Contributions may be made to the retirement system in addition to the required contributions by employes and/or employers. These contributions are held in separate reserve accounts and are subject to certain restrictions as to amount, form of benefit payments, tax status, etc.

#### Reserves

The following reserves have been established to reflect the legal restrictions on the use of pension trust funds.

#### A. Employe Accumulation Reserve

As authorized by Wis. Stats. § 40.04 (4), this reserve includes all required and voluntary employe contributions, including contributions made by the employer on behalf of the employe. This reserve may only be used to pay lump sum benefits, or transfers to the Annuity Reserve to fund annuities. The Employe Accumulation Reserve is fully funded.

Following is a summary of changes in the Employe Accumulation Reserve during 1999 (in millions).

	Fixed	Variable	Total
Beginning Balance	\$ 9,889	\$ 1,660	\$ 11,549
Plus:			
Contributions	428	16	444
Investment Income	1,084	409	1,493
Less:			
Separations	25	1	26
Retirement Lump Sum Benefits	6	0	6
Death Benefits	10	2	12
Annuity Reserve Transfers	648	202	850
Transfers	11	(6)	5
<b>Ending Balance</b>	\$ 10,723	\$ 1,874	\$ 12,597

#### B. Employer Accumulation Reserve

As authorized by Wis. Stats. § 40.04 (5), this reserve includes all required employer contributions, including contributions for amortization of the unfunded accrued actuarial liability. This reserve may only be used to pay lump sum benefits, or be transferred to the Annuity Reserve to fund annuities.

Following is a summary of changes in the Employer Accumulation Reserve during 1999 (in millions).

<b>Employer Accumulation Reserve</b>							
	Fixed	Variable	Police & Fire	UAAL	Total		
Beginning Balance	\$ 13,690	\$1,660	(2)	(37)	\$ 15,310		
Plus:							
Contributions	477	16		5	498		
Investment Income	1,962	408		(2)	2,368		
Prior Service Receivable Interest	145	0			145		
Less:							
Retirement Lump Sum Benefits	7	0			7		
Death Benefits	2	0			2		
New Annuities Approved	839	204			1,043		
Transfers	5	(6)	(1)	1	(1)		
Ending Balance	\$ 15,431	\$ 1,874	\$ (3)	\$ (33)	\$ 17,269		
Percent Funded					99.8%		

# C. Annuity Reserve

As authorized by Wis. Stats. § 40.04 (6), this reserve includes the present value of all annuities. The present value of new annuities are transferred from the Employe Accumulation Reserve and the Employer Accumulation Reserve to the Annuity

Reserve. This reserve may only be used for the payment of annuities and death benefits to annuitants. The Annuity Reserve is fully funded. Following is a summary of changes in the Annuity Reserve during 1999 (in millions).

		Fixed	Variable	Police & Fire	Total
Begini	ning Balance	\$ 14,814	\$3,400	\$ 128	\$ 18,342
Plus:	New Annuities Approved	1,492	407	0	1,899
	Investment Income	1,930	964	15	2,909
Less:	Annuities	1,484	334	14	1,832
	Transfers	7	(10)	0	(3)
Ending	g Balance	\$ 16,759	\$ 4,427	\$ 129	\$ 21,315

#### D. Undistributed Earnings

Wisconsin statutes require earnings be distributed to reserves based on a fixed effective rate truncated to a tenth of a percent, and a variable effective rate truncated to a percent. Because of the truncated earnings rates, small investment earnings balances remain undistributed at year end. These undistributed balances are distributed with the subsequent year's investment earnings.

#### E. Fair Value Adjustments

Wisconsin statutes require that a Transaction Amortization Account (TAA) be maintained to smooth the impact of market price volatility on the benefit plans invested in the Fixed Retirement Investment Trust (FRIT). All realized and unrealized gains and losses in fair value of investments in the FRIT are recorded in the TAA as they are incurred. Twenty percent of the TAA balance is transferred to and recognized as current investment income in the various program reserves of the FRIT at the end of each year. To recognize the legal restrictions on the use of the TAA for current operations, the fund balances of the participating programs are reserved for the amount in the TAA and shown as a Reserve for Market Value Adjustments (in millions \$).

Beginning Balance	\$ 11,495
Recognized Appraisal Gain	
(Loss):	
Domestic Equities	4,675
International Equities	2,101
International Bonds	(150)
<b>Emerging Market Equities</b>	246
<b>Emerging Market Bonds</b>	19
Nontraditional	19
Public Bonds	(1,022)
Private Placements	(8)
Real Estate	25
Special Account Adjustment	(12)
Transfer to Current Income	(3,478)
<b>Ending Balance</b>	\$ 13,910

# 1. Contingencies And Subsequent **Events**

#### **Special Investment Performance Dividend**

Wisconsin Act 27, Laws of 1987, authorized the transfer of \$230 million from the Transaction Amortization Accounts to the reserves of the FRIT. This amount was distributed to the various reserves based on the ratio of each reserve to the total assets of the FRIT. The transfer to the Fixed Employe Accumulation Reserve was credited to participant accounts in accordance with normal interest crediting procedures. The transfer to the Fixed Annuity Reserve was used for a "Special Performance Dividend" to those participants then receiving a supplemental benefit under 1985 Wis. Stats. § 40.27 (1) and (1m). If an annuitant's special performance dividend was equal to or greater than the previous supplemental benefit, the supplemental benefit was eliminated. If the special performance dividend was less than the supplemental benefit, the supplemental benefit was reduced by the amount of the special performance dividend. In a lawsuit brought by certain employe and annuitant groups, a circuit court ruled on July 29, 1991, that the distribution of the special performance dividend was unconstitutional. This decision was affirmed by the Court of Appeals on July 20, 1995 and the Wisconsin Supreme Court on January 17, 1997. As the result of a negotiated settlement approved by the circuit court on September 3, 1997, the state repaid \$215 million, less \$8.4 million in attorney's fees, to the Trust Funds on November 1, 1997.

The Employe Trust Funds Board determined that the settlement should be distributed so as to closely approximate the increases to WRS fixed annuities that would have taken place in 1988 if the SIPD had not taken place. The Board's distribution included a prospective increase to annuities with an effective date before November 2, 1987, and a lump-sum payment based on the Board's approximation of what would have been paid in the absence of the SIPD legislation if the

funds had been applied to increase the postretirement annuity adjustment effective on April 1, 1988. The Board also authorized interest to be paid on the lump-sum payments.

As of year-end, approximately \$82 million of the settlement had been applied to increases to annuities in effect on November 2, 1987. An additional \$115 million had been paid out in lump sum benefits to those annuitants having annuities in force as of November 2, 1987. Approximately \$14 million remains to be distributed to the estates of deceased annuitants. The deadline for estates to file claims for lump-sum payments is June 30, 2001, but may be extended if substantial numbers of claims remain unpaid as of that date.

#### 1999 Benefit Improvement Legislation

Wisconsin Act 11 (Act 11) was signed by the Governor on December 16, 1999, and became effective on December 30, 1999. On December 29, 1999 the Court granted a complete injunction preventing implementation of the provisions of Act 11 until further order from the Court.

The Employe Trust Funds (ETF) Board, and Eric Stanchfield, Department Secretary, filed a petition seeking a declaratory ruling on the legal issues surrounding Act 11. On February 10, 2000, the Wisconsin Supreme Court (Court) dismissed the petition filed by the Board, the Department and Secretary Stanchfield. The Court ruled that as agencies of the State, the Board and the Department have no standing to sue another agency of the State regarding the constitutionality of a law. The decision also ruled that Eric Stanchfield's petition as an individual member of the WRS was not sufficient to meet the standard for an exception to the normal rule on standing. On March 1, 2000, the original ETF petitioners formally requested the Court to reconsider its decision, and on March 8 the Court denied the petitioners' request for reconsideration.

The Wisconsin Education Association Council (WEAC), the State Engineers Association (SEA) and the Wisconsin Professional Police Association (WPPA) petitioned the Wisconsin Supreme Court to be allowed to intervene in the Wisconsin Act 11 lawsuit, asserting that they represent interests of participants in the WRS who will be directly affected by the outcome. The Supreme Court allowed WEAC, SEA and WPPA to intervene in the Wisconsin Act 11 lawsuit, and has made WPPA the petitioner. WPPA's complaint was similar to the ETF Board's complaint in many respects. SEA has been permitted to intervene as a petitioner and WEAC as a respondent.

The Court has also appointed a reserve judge to determine any factual issues and present his findings to the Court. After reviewing the judge's report the Court will decide whether to accept original jurisdiction of the case.

Act 11 would make a number of changes to the funding of and benefits provided by the Wisconsin Retirement System (WRS). Significant changes included in Act 11 are:

- Increase in the Formula Multiplier by 0.165% for service earned prior to 1/1/2000
- Increase in maximum formula benefit for non-protective participants
- Elimination of five percent cap on interest crediting
- Improved death benefits
- Reopening the variable trust for new participants
- Immediate recognition of \$4 billion from the Transaction Amortization Account
- Creation of a Market Recognition Account to replace the Transaction Amortization Account
- Reduction of the wage inflation assumption from 4.8% to 4.6%

### 8. Public Entity Risk Pools

The Department operates four public entity risk pools: group health insurance, group income continuation insurance, protective occupation duty disability insurance (Duty Disability), and long-term disability insurance (LTDI). In accordance with GASB Statement 10, these funds are accounted for as enterprise funds.

# **Group Health Insurance**

The Health Insurance fund offers group health insurance for current and retired employes of the state government and of participating local public employers. All public employers in the state are eligible to participate. The State, plus 195 local employers, currently participate. The fund

includes both a self-insured fee-for-service plan as well as various prepaid plans, primarily health maintenance organizations.

Following is a summary of the activity and changes in retained earnings for these individual risk pools within the Health Insurance Fund during 1999 (in thousands):

	<b>a.</b> .		Local Annuitants	
	State	Local	Amunams	Total
Investment Income	\$ 2,228	\$ 353	\$ 1	\$ 2,581
Insurance Premiums	<u>393,350</u>	42,607	<u>534</u>	436,491
<b>Total Revenues</b>	<u>395,578</u>	<u>42,960</u>	<u>535</u>	<u>439,073</u>
Claims Expense	57,717	3,757	0	61,474
Insurance Premiums	339,826	39,284	529	379,638
Carrier Administration	1,486	87	0	1,574
ETF Administration	<u>1,806</u>	<u>179</u>	<u>1</u>	<u>1,986</u>
<b>Total Expenses</b>	400,835	43,307	<u>530</u>	<u>444,672</u>
Net Income	(5,257)	(347)	5	(5,600)
January 1, 1999 Retained	10,316	4,302	4	14,622
Earnings				
December 31, 1999 Retained	<u>\$ 5,059</u>	<u>\$ 3,955</u>	<u>\$ 9</u>	<u>\$ 9,023</u>
Earnings				

#### **Group Income Continuation Insurance**

The Income Continuation Insurance fund offers both long-term and short-term disability benefits (up to 75 percent of gross salary) for current employes of the state government and of participating local public employers. All public employers in the state are eligible to participate. One hundred and two employers

plus the State currently participate. The plan is self-insured.

Following is a summary of the activity and changes in retained earnings for these individual risk pools within the Income Continuation Insurance fund during 1999 (in thousands):

	State	Local	Total
Investment Income	\$ 9,354	\$ 1, 348	\$ 10,702
Contributions	7,932	<u>889</u>	<u>8,821</u>
<b>Total Revenues</b>	<u>17,286</u>	<u>2,237</u>	<u>19,523</u>
Benefit Expense	6,357	(114)	6,243
Carrier Administration	675	47	722
ETF Administration	<u>757</u>	<u>64</u>	<u>821</u>
<b>Total Expenses</b>	7,789	<u>(3)</u>	<u>7,786</u>
Net Income	9,497	2,240	11,737
January 1, 1999 Retained	29,575	<u>6,715</u>	36,290
Earnings			
December 31, 1999	<b>\$ 39,072</b>	<u>\$ 8,955</u>	<b>\$ 48,027</b>
Retained Earnings			

#### **Duty Disability**

The Duty Disability fund offers special disability insurance for state and local Wisconsin Retirement System (WRS) participants in protective occupations. Participation in the program is mandatory for all WRS employers with protective occupation employes. The State and four hundred thirty-five local employers currently participate. The plan is self-insured, and risk is shared between the State and local portions of the plan.

The Duty Disability program is intended to compensate WRS protective category employes for duty-related disabilities. Benefits are payable for duty-related injuries or diseases that are likely to be permanent and that cause the employe to retire, accept reduced pay or a light-duty assignment, or that impair the employe's promotional opportunities.

All contributions are employer-paid. Contributions are based on a graduated, experience-rated formula. During 1999, contribution rates ranged from 1.8 percent to 7.9 percent of salaries based on employer experience.

During the program's initial years, contributions did not keep pace with benefits, resulting in both an accounting and a cash deficit. The Employe Trust Funds Board has increased contribution rates since 1985, and has implemented an experience-rated system to encourage employers to oppose frivolous claims against the program. After 1987 legislation (Wis. Act 363, Laws of 1987) broadened the Department's authority for experience-rated contribution collection and modified the benefit structure, a new rate structure was enacted which retired the cash deficit in 1993. The accounting deficit is being amortized over a twenty-three year period beginning in 2000.

In May 1997, the Wisconsin Supreme Court issued its decision in the Courts vs. Wisconsin Retirement Board case. The Court affirmed the Court of Appeals decision that Wis. Stats. §40.65, does not authorize the reduction of duty disability benefits by worker's compensation awards paid prior to the duty disability benefits effective date, and that duty disability benefits are not retroactive.

As a result, the Department is in the process of reviewing all duty disability cases in effect prior to the Court's decision date to identify the correct effective date and proper adjustment of Wis. Stats. §40.65 benefits paid to the recipients for periods of time after that date.

Benefit corrections made pursuant to the Coutts decision are not expected to have any material impact on the funded status of the plan.

## **Long-Term Disability Insurance**

Effective October 15, 1992, the Group Insurance Board established the long-term disability insurance (LTDI) program as an alternative to the long-term disability coverage provided through the WRS. The Employe Trust Funds Board purchases disability insurance coverage from the Group Insurance Board for WRS participants.

Participants who were covered by the WRS prior to October 15, 1992 have the option to select disability benefits from LTDI or WRS at the time of disability. New WRS participants on or after October 15, 1992 are eligible only for LTDI disability benefits.

A LTDI benefit replaces 40% of the disabled participant's final average earnings until normal retirement age, or a minimum of five years. It also provides for additional annual contributions to the participant's WRS account equal to 7% of the participant's final average earnings. At normal retirement age, or after a minimum of five years of LTDI benefits, the LTDI benefit terminates and the participant is eligible for a WRS retirement benefit.

The WRS pays actuarially determined premiums to the group insurance board for LTDI coverage. Beginning January 1, 1999 premiums have been suspended in recognition of the high funding level in the program.

# **Public Entity Risk Pool Accounting Policies**

- Basis of Accounting: All public entity risk pools are accounted for in enterprise funds using the full accrual basis of accounting and the flow of economic resources measurement focus.
- Valuation of Investments: assets of the Health Insurance fund are invested in the State Investment Fund. Investments are valued at amortized cost, which approximates fair value.
  - Assets of the Income Continuation Insurance, Duty Disability and Long-Term Disability Insurance funds are invested in the Fixed Retirement Investment Trust. Investments are valued at fair value, except for State Investment Fund shares, which are valued at amortized cost.
- Unpaid Claims Liabilities: The fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The estimate includes the effects of inflation and other societal and economic factors. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. Unpaid claims liability is presented at face value and is not discounted for Health Insurance. These liabilities are discounted using an interest rate of eight percent for the Income Continuation Insurance and Long-Term Disability Insurance and five percent for the Duty Disability program. The unpaid claims liability for the Health Insurance program was calculated by the Department. The liabilities for the Income Continuation Insurance, Duty Disability and Long-Term Disability Insurance programs were determined by actuarial methods. Face value of the liability for these programs is not available.
- Administrative Expenses: All
  maintenance expenses are expensed in the
  period in which they are incurred.
  Acquisition costs are immaterial and are
  treated as maintenance expenses. Claim
  adjustment expenses are also immaterial.

- 5. Reinsurance: Health insurance plans provided by health maintenance organizations and health insurance for local government annuitants are fully insured by outside insurers. All remaining risk is self-insured with no reinsurance coverage.
- 6. Risk Transfer: Participating employers are not subject to supplemental assessments in the event of deficiencies. If the assets of a fund were exhausted, participating employers would not be responsible for the fund's liabilities.
- 7. Premium Setting: Premiums are established by the Group Insurance Board (Health Insurance, Income Continuation Insurance and Long-Term Disability

- Insurance) and the Employe Trust Funds Board (Duty Disability) in consultation with actuaries.
- 8. Statutory Authority: All programs are operated under the authority of Chapter 40, Wisconsin Statutes.

# **Unpaid Claims Liabilities**

Each fund establishes a liability for both reported and unreported insured events, which is an estimate of future payments of losses. The following represents changes in those aggregate liabilities (in millions) for each fund during the past year. The amounts for Health Insurance include only the portion of the program which is self-insured.

	Hea Insur		Inco Continu Insura	ation	Duty D	isability	Long- Disab Insur	oility
	1999	1998	1999	1998	1999	1998	1999	1998
Unpaid claims at beginning of the calendar year	\$16.6	\$8.9	\$44.2	\$44.2	\$215.3	\$197.0	\$19.9	\$14.6
Incurred claims:								
Provision for insured events of the current calendar year	64.8	58.5	17.3	19.2	21.7	16.9	9.1	7.7
Changes in provision for insured events of prior calendar years	<u>(7.2)</u>	(0.2)	(11.8)	(11.5)	44.9	<u>16.9</u>	(0.3)	<u>0.6</u>
Total incurred claims	<u>57.6</u>	<u>58.3</u>	<u>5.5</u>	<u>7.7</u>	<u>66.6</u>	33.8	<u>8.8</u>	<u>8.3</u>
Payments:								
Claims attributable to insured events of the current calendar year	51.6	42.4	2.4	2.4	0.1	0.1	0.1	0.1
Claims attributable to insured events of prior calendar years	9.2	8.2	<u>4.4</u>	<u>5.3</u>	<u>16.9</u>	<u>15.4</u>	<u>2.7</u>	<u>2.9</u>
Total payments	<u>60.8</u>	<u>50.6</u>	<u>6.8</u>	<u>7.7</u>	<u>17.0</u>	<u>15.5</u>	<u>2.8</u>	<u>3.0</u>
Total unpaid claims at end of the calendar year	<u>\$ 13.4</u>	<u>\$ 16.6</u>	<u>\$ 42.9</u>	<u>\$ 44.2</u>	<u>\$264.9</u>	<u>\$ 215.3</u>	<u>\$ 25.9</u>	<u>\$ 19.9</u>

# 9. Description of Other Trust Funds

The Department also administers the Milwaukee Special Death Benefit, the Accumulated Sick Leave Conversion Credit program, the Employe Reimbursement Accounts program, Group Life Insurance program, Deferred Compensation, Public Employe Social Security, and the Milwaukee Retirement System Investment in the Fixed Retirement Investment Trust. These programs are administered in accordance with Chapter 40 of the Wisconsin Statutes.

# Special Milwaukee Death Benefit Fund

Members of the former Milwaukee Teachers Retirement Fund as of December 31, 1981, could elect to participate in a special death benefit fund. Since September 1986, participation in the program has been continued for eligible participants without premiums. The benefit amount and length of post retirement coverage is actuarially reviewed annually and adjusted as appropriate. The benefit amount has been set at \$3,500 since August 1988. During 1999, coverage was available to eligible participants for twelve years after retirement.

Effective January 1, 1998, the Group Insurance Board has contracted with the Minnesota Mutual Life Insurance Company to provide term life insurance coverage for participants in this plan. The benefit amount and coverage after retirement will continue to be set annually by the Group Insurance Board.

# Accumulated Sick Leave Conversion Credit Program

In accordance with Chapter 40, Wis. Stats., the State provides that employes retiring and beginning an immediate annuity are eligible for conversion of unused sick leave to post retirement health insurance. At the time of an employe's death or eligibility for an immediate annuity, that employe's accumulated unused sick leave balance may be converted at the employe's current rate of pay to credits for the payment of health insurance premiums for the employe and/or the employe's surviving dependents. Health

insurance premiums are paid on the behalf of the employe, until the sick leave conversion credits are exhausted. During 1995, this benefit was enhanced to provide partial matching of the sick leave accumulation depending on years of service and employment category. Accumulated sick leave conversion is pre-funded based on an actuarially determined percentage of payroll.

The actuarial valuation is based on the entry age actuarial cost method. Significant actuarial assumptions include an 8% assumed interest rate, 4.8% assumed annual salary growth, and an average sick leave accumulation of 6.1 days per year for state employes and 7.2 days per year for university employes. The accrued liability for the post retirement health insurance benefits at December 31, 1999, determined through an actuarial valuation performed on that date, was \$929.5 million. The program's net assets on that date, at actuarial value, were \$526.4 million, leaving an unfunded liability of \$403.1 million. The unfunded liability is considered an obligation of the State and is included in the general long-term debt account group in the State's comprehensive annual financial report.

Required and actual contributions totaled \$67.4 million during 1999.

# **Employe Reimbursement Accounts Program**

The Employe Reimbursement Accounts program, authorized by Internal Revenue Code Section 125, allows participants to contribute pre-tax earnings to an account to be used to pay eligible dependent care and medical expenses.

The Department contracts with a third-party administrator to provide administrative services, including participant accounting and claims processing, for the program.

Contributions are withheld from participant payrolls and remitted by the employer to the Department. The funds are invested by SWIB in the State's short-term investment pool.

Funds are transferred to the third-party administrator as needed for reimbursement of expenses to plan participants.

Administrative costs of the program are funded from the employers' Social Security savings on amounts contributed to the accounts by employes, along with interest earned on the fund balance and forfeitures from unclaimed contributions.

### **Group Life Insurance**

The Life Insurance Fund offers group life insurance for current and retired employes of the state government and of participating local public employers. All public employers in the state are eligible to participate. The State and 584 local employers currently participate. The plan is fully insured by an independent insurer.

Basic coverage is based on employe annual earnings for the prior calendar year (as reported to WRS) rounded to the next highest thousand dollars. Supplemental and additional life insurance are also offered. State employes pay contributions to cover the entire cost of the additional plan during active employment and a portion of the basic and supplemental plans. The State's share finances the cost of insurance after retirement plus a portion of the basic and supplemental plans. Local employers submit their contributions directly to the insurance carrier.

In accordance with Wis. Stats., Chapter 40, the State provides post retirement life insurance to employes retiring before age 65 if they (1) have 20 years of creditable service, and (2) are eligible for a retirement annuity. This coverage is at the employe's expense (employe must pay the full premium) until age 65 when reduced coverage is provided at no cost. Employes retiring at or after age 65 are immediately eligible for reduced coverage at no cost. When an insured annuitant reaches age 65, premiums are no longer collected and coverage is continued for life. Approximately 11,965 state and 15,352 local annuitants currently qualify for coverage without premium. Post retirement life insurance is fully insured by the State's life insurance carrier; premiums are pre-funded with employer paid premiums during the employe's active career. The amount of premiums is determined by the insurer. The accrued

liability and assets specifically related to post employment benefits could not be determined.

As of December 31, 1999, the following reserves (in millions \$) had been accumulated to fund the liabilities of the program. All reserves are held by the insurer.

	State of Wisconsin Plan	Wisconsin Municipal Plan
Reserves:		
Premium Deposit Fund	\$ 189.7	\$ 78.8
Contingent Liability Reserve	53.3	66.3
Disability Claim Reserve	<u>11.6</u>	9.2
Total Reserves	\$ 254.6	\$ 154.3
Liabilities:		
Retired Lives	104.5	50.9
Active Lives	133.2	78.9
Disability Claims	<u>11.6</u>	9.2
Total Liabilities	\$ 249.3	\$ 139.0
Unfunded Accrued Liability	<u>\$ (5.3)</u>	<u>\$ (15.3)</u>

The Life Insurance Fund also includes a Group Spouse and Dependent Life Insurance program for state and local government employes. Unless the employer provides otherwise, the entire cost of this program is financed by the employe. State employes pay a premium of \$2 monthly; local employes pay \$3 monthly. Basic coverage provides a benefit of \$10,000 for the death of a spouse and \$5,000 for the death of a dependent. An optional second coverage level in the State Plan doubles the coverage.

Contribution rates are set at a level sufficient to pay anticipated claims incurred during the year. No actuarial liability has been calculated for the plan as of the balance sheet date. The reserves for the Spouse and Dependent plan as of 1999 year end are as follows:

State of Wisconsin Plan	\$437,715
Wisconsin Municipal Plan	2,418,144

In the event of termination of the current group life insurance contract, the insurer would retain liability for benefits for all retired employes and those disabled employes under a waiver of premium. The insurer would retain assets equal to the Retired Lives Reserve and the Disability Claim Reserve. All remaining assets would revert to the Group Insurance Board in a series of installments.

The required and actual employer contributions totaled \$3.2 million state and \$1.8 million local during 1999.

#### **Deferred Compensation**

A Deferred Compensation plan, created in accordance with Internal Revenue Code Section 457, is available to all state employes and employes of local employers who have chosen to participate. The plan permits employes to defer a portion of their salary until future years. The deferred compensation is not available to employes until termination, death, or unforeseeable emergency.

The Department contracts with an independent agent to administer the plan. Employers remit employe contributions directly to the administrative agent. The administrative agent transmits the contributions to one or more investment vehicles selected by the employe. All records detailing the contributions, earnings, and balance on deposit for individual participants are maintained by the administrative agent.

Effective January 1, 1997 the Deferred Compensation Board amended the plan document to provide that all assets and income of the plan are to be held in trust for the exclusive benefit of the participants and their beneficiaries in compliance with the provisions of IRC Section 457(g).

Of the \$1,198 million Deferred Compensation fund balance, \$8.2 million relates to fixed, insured annuities while the remaining funds are subject to market fluctuations.

#### **Social Security**

In accordance with Section 218 of the Federal Social Security Laws, the State entered into an agreement with the federal Department of Health and Human Services whereby the State underwrites and guarantees the payment of all public employer and employe Social Security contributions of personnel whose services are covered by the agreement. This agreement was amended effective January 1, 1987, to eliminate the Department's role in collecting contributions, at which time public employers began remitting contributions directly to the Social Security Administration. The Department remains the guarantor for local government payment of social security contributions. During 1994 the fund was closed by transferring all remaining assets to the Fixed Pension Trust Fund.

#### Milwaukee Retirement Systems

The Milwaukee Retirement Systems (MRS), consisting of the City of Milwaukee Retirement System and the Milwaukee Public Schools Retirement System, is reported as an Investment Trust Fund. MRS provides assets to the Department for investing in the Fixed Retirement Investment Trust (FRIT), described in Note 1 "Investment Valuation". The FRIT is managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statute 25.17. It is not registered with the Securities and Exchange Commission as an investment company. Participation of the MRS in the FRIT is described in the DETF administrative code, chapter 10.12.

Monthly, the Department distributes a pro-rata share of the total FRIT earnings less administrative expenses to the MRS accounts. The MRS accounts are adjusted to fair value and gains/losses are recorded directly in the accounts per DETF Administrative Code Chapter 10.12(2).

Neither State statute, a legal provision, nor a legally binding guarantee exists to support the value of shares.

At December 31, 1999, the FRIT held a number of nonnegotiable short-term certificates of deposit. The fair value of these

certificates of deposit was \$28.4 million, all of which was uncollateralized.

At December 31, 1999, the FRIT held \$55,625.2 million of investments of which \$700.8 million are classified as cash equivalents. In addition, the FRIT held

\$2,757.5 million of securities lending collateral. The following table presents investments of the FRIT at December 31, 1999, categorized in accordance with the level of risk requirements of GASB Statement No. 3 (in millions):

		Category (in n	nillions)	
	<b>"1"</b>	"2"	"3"	Fair Value
Bonds	\$ 9,646.4	\$ 0	\$ 0	\$ 9,646.4
Stocks	18,749.7	7.3	0	18,757.0
Repurchase Agreements	13.7	0	0	13.7
Bankers Acceptances	<u>525.8</u>	<u>0</u>	<u>0</u>	<u>525.8</u>
Totals	<u>\$ 28,935.6</u>	<u>\$ 7.3</u>	<u>\$ 0</u>	<u>\$ 28,942.9</u>
Investments Not Subject to Ca	tegorization:			
Pooled Equities				15,059.1
Private Placements				3,126.4
Pooled Bonds				4,059.9
Limited Partnerships				2,520.1
Investment in State's Investme	nt Fund			476.1
Pooled Cash and Cash Equival	ents			224.8
Mortgages				386.5
Real Estate				448.3
Financial Futures Contracts				0.3
Options				48.3
Investments Held By Broker D	ealers Under Securities l	Loans:		
Bonds				2,094.5
Equities				584.1
Securities Lending Cash Colla	teral Pooled Investments			411.5
Totals				\$ 58,382.8

The following schedule provides summary information by investment classification for the FRIT at December 31, 1999 (in millions):

Classification	Interest / Coupon Rate	Maturity Dates	Cost	Fair Value
Bonds	Variable and .08 to 14.50	1/00 to 1/36	\$14,282	\$13,994
Common and Preferred Stock	N/A	N/A	28,801	34,400
Options	N/A	N/A	23	49
Limited Partnerships Real Estate	N/A	N/A	2,305	2,520
Mortgages	6.77 to 12.25	2/00 to 6/22	379	387
Real Estate	N/A	N/A	404	448
Financial Futures Contracts	N/A	N/A	0	0
Private Placements	Variable and 5.3 to 14.75	1/00 to 12/31	3,067	3,126
Total Investments			49,261	54,924

Significant financial data for the FRIT for the year ended December 31, 1999 is presented below (in thousands):

Fixed Retirement Investment Trust Condensed Statement of Net Assets As of December 31, 1999 (in thousands) Fixed Retirement Investment Trust Condensed Statement of Changes in Net Assets For the Year Ended December 31, 1999 (in thousands)

Assets:		Additions:	
Cash & Cash Equivalents	\$ 749,180	Net Appreciation (Depreciation) in	\$ 5,905,390
Securities Lending Collateral	2,757,489	Fair Value of Investments	
Prepaid Expenses		Interest	1,186,425
Due From Other Trust Funds	4	Dividends	404,795
Investment Receivables	275,762	Real Estate Income	51,863
Investments, at Fair Value	54,924,441	Securities Lending Income	185,883
Total Assets	58,706,876	Other	<u>79,520</u>
		Total Additions	<u>7,813,876</u>
Liabilities:			
Securities Lending Collateral	2,757,489	<b>Deductions:</b>	
Liability		Investment Expense	74,503
Investment Payables	48,993	Securities Lending Rebates and Fees	168,513
Total Liabilities	<u>2,806,482</u>	Net Withdrawals by Pool Participants	431,273
		Total Deductions	674,289
Net Assets Held in Trust For:			
Internal Investment Pool Participants	55,787,987	Net Increase (Decrease)	7,139,587
Milwaukee Retirement Systems	112,407	Net Assets Held in Trust for Pool	
Total	\$ 55,900,394	Participants	
		Beginning of Year	48,760,807
		End of Year	\$ 55,900,394